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economic Review

Reconstruction of the Yugoslav Foreign Debt*

The agreement between the FR Yugoslavia and the Paris Club of creditors reached on November 16 is of historic significance. Yugoslav foreign debt could be reduced by up to 5 billion USD (from about 11.4 billion USD at the end of July 2001). Therefore, it might be assumed that: **(i)** The FRY will make and implement a new three-year agreement with the IMF; and **(ii)** The commercial creditors (the London Club and others) will restructure the Yugoslav debt under similar conditions as agreed to with the Paris Club of creditors.

The agreement with the Paris Club (and the accompanying agreements, as well) means that the decrease in Yugoslav foreign debt is greater than the total debt increase during the period 1991-2001. In other words, Yugoslavia is given a chance for a fresh start. The simple interest accrued between 1991and 2001 will be written off, as well as a share of the debt made prior to 1991.

FRY Basic Economic Indicators	2000	2000 / 1999	X 2001	X 2001 / IX 2001	X 2001 / X 2000	I-X 2001 / I-X 2000
GDP growth, in real 1994 prices[a]	...	**8.4%**	...	...	...	...
Industrial Production	...	**10.9%**	...	**10.3%**	**18.0%**	**-1.4%**
Montenegro	...	3.7%	...	10.3%	-10.1%	-1.7%
Serbia	...	11.4%	...	10.3%	20.2%	-1.4%
Central Serbia	...	12.0%	...	6.4%	11.5%	-6.1%
Vojvodina	...	10.1%	...	17.1%	37.7%	9.3%
Average nominal net wage - Serbia in Din.[1]	**2,389**	**89.5%**	**6,553**	**5.5%**	**124.0%**	**136.1%**
Real net wage - Serbia[1]	...	**5.5%**	...	**2.6%**	**37.8%**	**12.6%**
Average net wage - Serbia, in DEM[1]	**93**	**-11.2%**	**215**	**5.5%**	**119.6%**	**131.4%**
Average net wage - Serbia, in DEM[2]	...	...	**243**	**7.4%**	...	...
Average gross wage - Serbia, in DEM[2]	...	...	**349**	**7.1%**	...	...
Unemployment Rate - registered[3]	**28.38%**	...	**29.9%**	**-0.1%**	**3.4%**	**4.3%**
Montenegro	...	...	38.9%	-0.7%	...	...
Serbia	27.45%	...	29.2%	-0.1%	4.9%	4.9%
Current account, in USD millions[4]	**-1,298**	**3.2%**	**-456**	**36.9%**	...	**-5.0%**
Trade balance, in USD millions	**-1,989**	**-10.6%**	**-215**	**40.5%**	**77.7%**	**41.1%**
Export - USD million	**1,713**	**15.0%**	**156**	**-1.9%**	**14.1%**	**6.2%**
Montenegro	157	31.1%	5	150.0%	-62.6%	3.1%
Serbia	1,411	13.8%	150	-4.5%	21.4%	6.5%
Import - USD million	**3,662**	**12.6%**	**371**	**18.9%**	**43.9%**	**25.0%**
Montenegro	313	-1.0%	21	24.8%	-10.7%	35.2%
Serbia	3,035	15.6%	348	18.9%	49.1%	23.4%
Monetary supply (M1), end of period, in DIN billion	**29.6**	**60.7%**	**56,396.4**	**7.17%**	**135.75%**	**107.27%**
Cash	10.3	39.8%	19,066.5	8.08%	133.43%	94.57%
Deposits	19.3	74.9%	37,329.9	6.71%	136.96%	114.80%
Real money supply, end of period, in DM million	**1,043**	**-26.7%**	**1,842.5**	**6.90%**	**140.85%**	**89.03%**
Hard currency reserves, in million USD (end of period)	**524**	**76.2%**	**1,080**	**3.0%**	**200.2%**	...
Discount rate	...	...	**1.30%**	**0.00%**	**-35.00%**	**-25.00%**
Market interest rate, monthly level	**5.84%**	**37.3%**	**4.17%**	**-3.47%**	**-38.22%**	**-12.31%**
Retail prices – Serbia	...	**70.0%**	...	**2.6%**	**65.5%**	**108.9%**
Consumer prices – Serbia	...	**79.6%**	...	**2.9%**	**62.5%**	**109.7%**
Producer prices – Serbia	...	**102.6%**	...	**2.1%**	**68.6%**	**105.4%**
Average exchange rate – Din./DEM	**25.45**	**103.2%**	**30.61**	**0.2%**	**-6.0%**	**19.4%**

[a] Figures refer to FRY without Kosovo
[1] Comparable to the average net wage calculated according to the method applied until June 1, 2001.
[2] By the gross wage calculation methodology applied as of June 1, 2001.
[3] Figures refer to September 2001.
[4] Figures refer to the period January – June 2001.

In this issue:

Let us have a look at the details of the agreement with the Paris Club of creditors. **(1)** In the first phase of the implementation of the Agreement until the end of March 2002, the payment of the debt is postponed. **(2)** In the second phase, after a three-year agreement with the IMF is made, 51% of the debt (meaning the current net value) will be written off. **(3)** After successful accomplishment of the three-year agreement, another 15% of the debt will be written off, thus reducing the total debt by 66 %. **(4)** The total remaining debt will be reprogrammed with a maturity period of 22 years and a grace period of 6 years, with the interest rate set on the money market. **(5)** 60% of the interest that matures between March 2002 and March 2005 will be capitalized.

A total debt reduction of 66%

As a result of the Agreement, the annual debt payment to the Paris Club will be limited to 30 million USD in 2002, 50-60 million USD in the period 2003-2004, and under 100 million USD subsequently. Without the Agreement, the payment of the debt to the Paris Club would exceed 250-300 million USD in the period 2003-2004 (Houston terms, i.e. no reduction of the debt).

If all commercial credits were reprogrammed under terms similar to the ones agreed with the Paris Club, the total payment of the foreign debt would be about 320 and 440 million USD in 2002 and 2003 respectively. Under the Houston terms, the total payment would be 751 million USD in 2002 and 958 million USD in 2003.

The *amount saved in debt servicing* would be huge, reaching 5-6% of GDP already in 2002. This means significant relief to taxpayers and enterprises, opening the possibilities for tax reduction and larger social and infrastructure spending. It would also enable the enterprises which are heavily in debt to survive and develop.

Relieving tax-payers and enterprises

Not only will the reduction of the debt improve the situation in the public sector, but it is also the most significant prerequisite for private investments. It is more likely that private investors will invest if the potential tax burden in the future is not to be increased due to the payments on foreign debt. In other words, the reduction of foreign debt diminishes the economic risks for private investors giving them the opportunity to invest in Yugoslavia. However, there is still a certain political risk and a lacking in the legal framework for private economic activity that stand as significant obstacles for investments in private sector.

Consequently, the reduction of the foreign debt itself is not sufficient for the growth of salaries, income and employment in the FRY. It is necessary to carry out economic reforms in order to attract both domestic and foreign investors. Unless the annual economic growth of 5% is sustained, as well as a fast increase in exports in the coming years, the FRY will not be able to service its debt on regular basis and will enter into a new balance of payments and debt crisis. This would inevitably limit private investments and halt growth, causing a further decrease in living standard, as well. In other words, the reduction of the debt gives the reforms an opportunity to be successful, but the success is not guaranteed without political contributions to that success.

But macroeconomic stability will deteriorate without microeconomic reform

Imagine the following situation: if it had not been for the reduction of the debt by the Paris Club, and hopefully by the other creditors, the total GDP growth projected for 2002, 2003 and most likely for the forthcoming years would have been used for the regular servicing of the debt. What would be the stimulus for continuation of the reforms under such circumstances?

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The Law on Employment

The efficiency of the national economy is an extension of the efficiency of individual enterprises, shops, public service institutions (education, health care, culture, etc.), and state bodies. A working environment with the appropriate legal regulations and immanent institutions is extremely important for the efficiency in their work. Consequently, the transitional reforms can not be imagined without changes to laws and institutions.

Reform must begin with legislation

Inefficiency in the formerly state-owned and socially-owned enterprises in Serbia in the previous decades resulted from the inadequate ownership environment. Social ownership was the basis for legal regulations in the economy. The laws and accompanying regulations on employment are the most important in that sense, because they regulate the relations between the main factors of production:

(1) Labor, encompassing the knowledge, skills and devotion of the employees, and

(2) The organizers of the working process which is based on social – ownerless capital

With such, in an economic sense, an unnatural relation, neither of the participants in the working process was motivated to increase productivity. Even when they did not really work, the employees were receiving salaries, and the management did not have responsibility for failures or for not realizing the potential volume of production and services. The state encouraged this condition through decrees and other decisions directly connected to the enterprises, which derogated the existing laws.

Thus, especially during the previous decade, the responsibility for social and state capital management was completely eliminated. It enabled capital outflow from enterprises to a small number of individuals – members of the elite in power that were mutually connected at all levels. The employees were quite often the pure executors of this elite's speculative actions and were largely unaware that they were ruining the basis of their own work and earning.

The Need for a Natural Replacement

Liberalization of the labor market is key to the success of industrial restructuring

Everything mentioned so far unambiguously lead to the conclusion that reform of the legislation on employment is the main segment of the current process of reforms in Serbia. It was right to start from the Law on Employment, which recently was sent in the form of a Government law proposal to the Parliament for adoption. It is important to stress that the suggestions in this commentary are based on the results of many studies on the way the labor market in Serbia functions.

The conception of the proposed Law on employment is characterized by three main problems:

1. Breaking with the past;
2. Creation of a market-oriented environment;
3. Serving as a basis for the creation and realization of a national policy on the labor market.

The first question refers to freeing enterprises from social functions. In our estimation, in Serbia without Kosovo and Metohija, there are over 650,000 "hidden" unemployed persons in the formerly socially-owned enterprises. The main condition for restructuring these enterprises is an efficient solution to the problem of redundant labor that has been cumulated for years.

This is possible only through liberalization of the labor market with the application of active and passive measures of labor market policy. According to these standards, the proposed solutions for the transition period are good. The market-oriented environment is a basic premise for:

1. Motivating entrepreneurship;
2. Inflow of foreign investments;
3. Social dialogue set on "healthy" foundations.

The encouragement of entrepreneurship provides new jobs and affects the rise in employment. The establishment of new private enterprises as the result of the encouragement of entrepreneurship is a basic condition for restructuring the current labor market in Serbia, together with active measures of the labor market policy.

In the previous period a great number of the formally employed were on so-called paid-leave and lost touch with their original profession. For some of these employees it is necessary to revise old and gain new knowledge, in order to take new jobs or to prepare themselves for self-employment. On the other hand, there is a need for a natural replacement, considering that among the employed in Serbia, only 4% are young people of 15-24, while the share of this age group among the unemployed is 35%.

The Opportunity to Choose an Employer

SMEs too do best in liberal labor markets

New profitable programs require flexibility of labor in every sense, including the possibility to choose employment. It is necessary for employees to have the possibility to choose the employer, as well. With its liberalization, the Serbian labor market will come closer to the labor markets in developed European countries, which should attract investors from these countries, as well as investors from other countries in the world to invest and create new employment opportunities in Serbia.

The new Law on employment enables the establishment and implementation of a real social dialogue among the relevant partners in the labor market:

1. The trade unions as the representatives of the employees;
2. The unions of employers, and
3. The state.

This includes all possible requests from any partner under the new liberalized conditions, as well as resolving the problem of redundancies in the process of restructuring the existing inefficient socially-owned or state-owned enterprises.

The main instrument of regulating the employment issue is a contract on employment, while the collective bargaining agreement is not binding if the employer does not sign it. In the current stage of transition in Serbia, this is very significant, since it is the only way to achieve the differences in expression of particular knowledge and skills as an important condition for competition at the labor market.

On the whole, it might be observed that the proposal of the law on employment is a modern one. It brings the conditions of the Serbian labor market significantly closer to those countries with a developed market economy. It is a key law and its adoption will be a turning point in the process of transition in Serbia confirming the true commitment for the continuation of reforms.

Only after this law is adopted, might we expect relatively fast and efficient reform of the real sector and the establishment of new private enterprises. It means new employment opportunities and successful resolution of the huge "hidden" and real unemployment.

Electronic Commerce and Electronic Signatures

Electronic commerce stands for conducting business by electronic means, through exchanging business message between the subjects of legal traffic. As such, it exceeds the limits of contract law. Electronic commerce is often identified with electronic trade, but they are not synonyms. Electronic trade includes only selling and purchasing goods and services, but not other forms of legal traffic. Electronic commerce requires an electronic signature, i.e. the data in electronic form, added or logically joined to other electronic data, aimed at assuring the integrity and irreversible character of data and identification of the signatory.

The electronic signature is vital to e-commerce

In e-commerce, the expenses are reduced and economic activities are improved. This is confirmed in the UN Economic Commission for Europe study, which emphasizes that this way of conducting business is as much as a thousand times cheaper than the classic form, aside from being incomparably faster. This is reason enough to focus proper attention on legal organization of this issue. Although Yugoslavia was excluded from world courses, it has capacities to hold them again, especially in e-commerce. Although it is not possible to apply any existing solution due to the specific features of each legal system, the experiences of other countries could facilitate the work of our own experts, especially lawyers and economists.

Work on Legal Regulation

Electronic commerce started spreading in the early 1990s when commercial usage of the Internet was enabled. Legal safety of electronic commerce required normative regulation of the whole procedure of electronic commerce in order to provide its reliable functioning and development. Regulation evolved gradually, looking first to electronic trade, followed by electronic signatures, and finally, electronic commerce as a whole. The problems in legal regulation of electronic commerce result from the fact that it is a business area with constant and fast changes. Further, it is generally used by people of technical occupations, while is rather unknown to others.

States must cooperate to regulate

In a legal sense, the main problem related to this issue is the question of prerogatives, since the essential feature of e-commerce is that it exceeds the borders of one state. The experts have different opinions on the legal regulation of electronic commerce. For some, legal regulation of this issue is not needed, while others find it necessary. Both approaches could be defended by appropriate arguments. The facts, however, show that the economic criminal has a new form and environment. Therefore, the electronic commerce issue might be regulated best within international organizations.

The advantages of this approach are obvious since uniformity in regulation is achieved. The disadvantages refer to the fact that it is hard to find a solution that suits everybody, the negotiations are long and adopted acts are binding only to the countries that ratify the convention and implement it into their internal legislation. In a 1996 report, the OSCE suggested that, with regard to the global character of electronic commerce, states should encourage digital commerce and create conditions for as liberal as possible legal regulations.

However, the liberal approach may affect the legal safety, which has been proved in practice many times.

The solution is found through adopting the basic texts and model-laws on electronic commerce and electronic signatures. They are not the subjects of ratification, but every country which wants make its own law may use them as a pattern. The practice of model-laws is especially wide spread in the USA. The formulations of the model-laws are not binding, and the states are free to adjust the offered solutions to the special characteristics of their own national legal systems.

Model laws are an excellent tool in the absence of international regulation

The comparative analysis shows that the most important acts in this area were made within the UN Commission For International Trade Law – UNCITRAL and the European Union. In 1996 UNCITRAL prepared a model-law on electronic commerce, while the model-law on electronic signatures was adopted on July 5, 2001. The laws in Slovenia, France, Ireland and Austria are prepared in accordance with the UNCITRAL model-law. It also influenced the regulations adopted in Canada and the USA.

As opposed to the model-law on electronic commerce, the guidelines for implementation of the model-law on electronic signatures in internal legislation have not been issued yet. The model-law is more flexible instrument than the international contract or uniform law. In the European Union, the issues of electronic commerce and electronic signatures are regulated by the directives. (Directive no. 1999/93/CE on common framework for electronic signatures EC Official Journal no. L 013 of January 19, 2000; Directive no. 2000/31/CE on certain legal aspects of the services of electronic society, especially the electronic commerce at the internal market "Directive on electronic commerce", EC Official Journal no. L 178 of July 17, 2000)

Work on the Law Proposal in Yugoslavia

The development of e-commerce in the FRY requires normative regulation of this area, especially considering the preparation of its candidacy for membership in the European Union and other international organizations.

The domestic demand for e-commerce regulation is clear

At the meetings held in the Yugoslav Chamber of Commerce, the interest of the companies in electronic commerce is clear, especially of those who have good opportunities for the export of their goods and services. Among economic and financial subjects in the FRY, there is an awareness of the necessity and large benefits of electronic commerce - it enables more economical business, easier communication with domestic and foreign partners, and other commercial advantages at the market.

In August 2000, The State Bureau of Informatics initiated the creation of the Law on Electronic Commerce and Electronic Signature (hereinafter: the Law). The former Ministry for Development, Science and Environment accepted the initiative and on August 24 founded an expert team for creation of the Law. The experts' idea was to include the public in their work through the Federal Government web presentation.

The European Union as a Model

The FRY's determination to join the European integration process and its aspiration to become a part of the big European family should be a guiding idea to the members of the expert team in creation of the law. The EU legal system, although very complicated on the first glance, follows the simple logic of unification and harmonization. Unification and harmonization in the Union are achieved through two sources of Community law: decrees and directives. **Decrees** are general legal enactments made by the community organs that unify the issues standardized by a certain regulation. They are applied directly in the member states without being incorporated by special internal acts. **Directives** are general regulations through which the harmonization of the member states' legislation is achieved. The directives only determine the objectives of future legal regulations, leaving the member states to adopt internal laws through which those objectives will be achieved. Theoretically speaking, member states are free regarding the way of achieving the determined objectives and contents of the regulations themselves, thus reminiscent of model-laws. The directives adopted so far, however, leave little maneuvering space.

The expert team was primarily inspired by the solutions in Irish and Slovenian laws on electronic commerce, rather than by the original text, i.e. the EU Directives. Ireland as an EU member has not adjusted its law to the new EU regulation yet, and is required to do so by January 17, 2002. Slovenia, although is in negotiations and by all indicators is the country that will be first adopted into full membership in the course of 2004, has the same obligation, not as a country-member, but as an applicant country, thus accepting the obligation to harmonize its internal legislation with EU regulations.

The Proposed Law

But the draft law is far from ideal

The Law proposal has 48 articles divided into 6 chapters. In the first chapter (art. 1 and 2), the main terms used in the text are explained. In the second chapter named "Electronic commerce" (art. 3 – 11) the following issues are regulated: the basis of electronic commerce, electronic data, sending and reception of electronic messages, confirmation of reception, time and place of sending and reception, and the signing of a valid electronic contract. The third chapter deals with the qualified electronic signature (art. 12-15), its generation and verification. The fourth chapter deals with the Certification body (art. 16-31), its accreditation, the contents of the certificate, validity of foreign qualified electronic certificates, terms for issuing and suspension of qualified electronic certificates, storage of issued qualified electronic certificates, the responsibility of the Certification body, protection of personal data, and resolution of disputes. The fifth chapter that stands also as the beginning of the second part of the law deals with penal enactments (art. 32-45), while the sixth chapter consists of the transitional and final enactments (art. 46-48).

The text of the Law, after several corrections, should enter the parliamentary procedure, but some basic questions are still not resolved.

Shortcomings of the Proposed Law

The Law as proposed is not consistent concerning exceptions: it does not distinguish general exceptions and exceptions in contracts. Especially significant is the issue of the regulation of financial transactions. This is explicitly excluded from the area of the EU Directive application, and is not incorporated in our law proposal. However, the current legislation in the FRY (Law on financial transactions, The

FRY Official Register no 24/98, 74/99, 28/00, 73/00) gives a possibility for electronic financial transactions, but lacks sufficient regulatory acts. While the Law on electronic commerce should not regulate financial transactions, practice demonstrates that most e-commerce misuses occur in electronic financial transactions (e.g. credit cards, direct account-to-account and country-to-country transfers without the evidence of the transfer, etc) and therefore this area must be regulated with special enactments.

Our proposal deals explicitly with the qualified electronic signature and one special chapter of the Law is dedicated to it. The title mentions the electronic signature (singular), although the comparative law uses the plural form (not: electronic signature, but electronic signatures), which is understandable regarding the fact that encouragement of electronic commerce requires more modalities of an electronic signature. It looks, however, as if the electronic signature, besides the qualified one, was included in the Law in the last moment, since it is mentioned in two places in the proposal. But, it is still not clear in what cases the latter could be used.

The structure of the proposal is somehow inconsistent since some questions are regulated in details, particularly the Certification body, while at the same time it projects the adoption of the special act that would regulate this matter.

Despite EU Directives, no consumer protection in the FRY draft

The text of the Law does not have a provision that explicitly protects the consumers' interests, although it has been stressed several times in the EU Directives. With regard to the wider interpretation and the fact that the Law proposal projects the qualified electronic signature as the highest degree of security of electronic transactions, it could mean that the widest possible protection is considered, but this is not explicitly declared.

Conclusion

Although a need for the law that would regulate the matter of electronic commerce and electronic transactions was observed, there was not enough coordination in the expert team's work when crafting the draft in question. Since the law regulates a multidisciplinary subject, experts of various profiles should have cooperated on the law proposal. It is indisputable that the experiences of other countries that have already passed this way are helpful, but the original EU documents should be used, as well.

It is alarming that no one from the administration of justice participated in the creation of this law proposal, even though judges are the ones who are to apply the law when a dispute arises. The question is to what extent the terms used in the Law are understandable for them, and even more, how the court procedures will look. The area of e-commerce and application of electronic signatures require all related disputes to be resolved in the shortest possible period.

The story about electronic commerce is incomplete if we do not mention the Internet criminal. A very common practice in our country is ordering goods by way of "borrowed" credit cards or their numbers. During the isolation period in Yugoslavia, little attention was paid on this problem. It was not understood as a criminal act. However, our country restored its membership in Interpol and criminal charges began to arrive, followed by inevitable unpleasant consequences.

Reforming the Old Age Pension & Disability Insurance System

In light of the existing financing problems of pay-as-you-go social security pension systems (pension systems with current financing) and the greater difficulties they will face in future as the demographic situation deteriorates, the issue of pension reform is becoming a matter of growing importance in developed countries, developing countries and countries in transition.

The various benefits and costs arise from the alternatives available, with the major emphasis being on funding. Of course, there are not ready-made solutions that could be applied in all countries with equal efficiency. A close study of the specific circumstances in Serbia is necessary, as well as examining if the solutions applied in similar circumstances (e.g. Poland, Hungary, etc.) could be applied in our country, too.

Social Security Pension System in Serbia

The social security pension system in Serbia is pay-as-you-go, i.e. a system with current financing, where present workers through their contributions finance the pensions of today's pensioners, while in return they are promised the support of future generations of workers when they grow old. The state establishes, maintains and administers this social contract. In its initial stage, with the more favorable demographic situation (many young people who work and a relatively small number of pensioners) such a system works very well. In the course of time, however, the first problems arise. Unfortunately, the problems that our social security pension system faced were cloaked by the entire situation in Serbia in the last decade.

The most significant characteristics and problems that our pension system faces today are the following:

Pension reform is of growing importance

1.) The great number of pensioners compared to the number of employed who pay the contributions. It might be better formulated as the small number of employed compared to the number of pensioners with regard to the long-term situation in our economy. In September 2001, the ratio of active contribution payers to the number of pension beneficiaries was 1.21 in the Old-age Pension and Disability Insurance Fund of Employees, 2.08 in the Old-age Pension and Disability Insurance Fund of Farmers and 5.26 in the Old-age Pension and Disability Insurance Fund of Self-employed. Even European countries with the worst ratio of the number of the active contribution payers to the number of pension beneficiaries (Belgium, Greece, Portugal) and those with very liberal conditions for retirement (Belgium, Italy) do not face such unfavorable proportions of the employed to pensioners. The more favorable ratio in the Old-age Pension and Disability Insurance Fund of Self-employed is owing to the fact that the Fund is in the so-called "young" stage of the pay-as-you-go system (the beneficiaries of the Fund are self-employed persons, and many of them initiated this kind of employment only ten years ago), and consequently the Fund does not face the problems typical for "the mature" stage at present.

Such an unfavorable ratio of the number of active contribution payers to the number of pension beneficiaries is largely due to the policy of the former regime, in which the pension system served as a way for resolving various social problems and primarily the problem of unemployment (This was not the case only in our country). Such shortsighted policy did not lead to a significant increase in employment, while on the other side it caused a large number of long-term problems.

2.) The aforementioned is confirmed by the data on **early retirement** in Serbia: the average individual age for retirement in 2000 was only 58 (61 for men and 56 for women). Persons of that age are still vital and able to continue working and paying contributions.

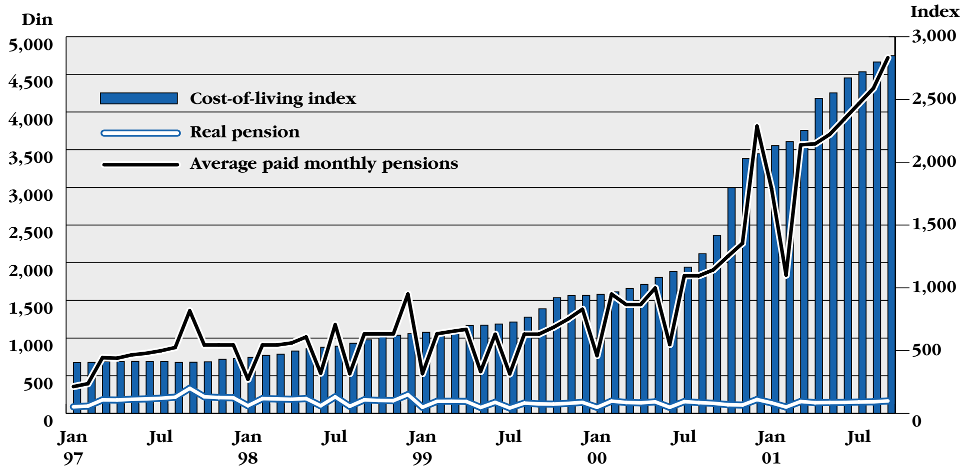
3.) Another feature of our pension system is that the **disability and survivor's pensioners have a proportionally high share in the total number of pensioners**. In July 2001, the share of disability pensioners in the Old-age Pension and Disability Insurance Fund of Employees was 31.6% and in the Old-age Pension and Disability Insurance Fund of Self-employed 35.5%, whereas in December 2000 in the Old-age Pension and Disability Insurance Fund of Farmers it was 4.33%. The share of survivor's pensioners in total number of pensioners is also high, reaching 25% in the Old-age Pension and Disability Insurance Fund of Employees, 28.8% in the Old-age Pension and Disability Insurance Fund of Self-employed in July 2001, and 8.4% in the Old-age Pension and Disability Insurance Fund of Farmers in December 2000.

4.) **The ratio of the average pension to the average net wage** is very high, ranging from 1 in 1997 to 0.75 in the first nine months of 2001. For the old-age pensions, this ratio is even more unfavorable, varying from 1.2 in 1997 to 0.98 in the first nine months of 2001.

5.) Despite such an unfavorable proportion between pensions and wages, **the value of the pensions is very low**, often being at the level of the existential minimum or even under it. Distribution of the number of pension recipients according to the value of pension in September shows that about 59% of pension beneficiaries of the Old-age Pension and Disability Insurance Fund of Employees received a pension of 4,727 dinars (DEM 155).

Average real pensions were up in 2001

Cost-of-Living Index, Nominal and Real Pensions



In the period 1997-2000, average nominal and real pensions were maintained at a level of 1000 dinars or 98 DEM (calculated according to the rate of exchange set at the market), with some monthly variations. The former regime had kept the pensions at a very low level by deliberately avoiding wage-indexing the value of the pension (which should have been enacted under the Law) and by being late in payments (more than two pensions per year). Implementation of the principle of regular pension payment and adjustment in the pension value led to a significant increase in the nominal and real pension as compared to the relatively slower increase in costs of living in the previous months of 2001.

...but so were mortality rates among pensioners

6.) **The contribution rates were very high in the previous period.** (Prior to its reduction to 19.6% in June, the contribution rate was 32% - one half was paid by the employer and the other half by the employee). Such high rates could not solve the problem of financing pensions. Namely, they have the complete opposite consequence: they encouraged the evasion of contributions and further overburden wages of those employed in the regular economy. The current contribution rate of 19.6%, however, is not enough for full financing of the pensions. The deficit reaches approximately 2.1 billion dinars per month, or 33% of funds for full financing of the pensions (or 2.3 billion dinars if we consider 33,000 pensioners on the territory of Kosovo and Metohija who are paid pensions, while the state does not collect contributions there).[1] Such a trend will continue in the upcoming period, so that the shortage of sources in January 2002 will be about 2.4 billion dinars, or 34% (2.5 billions including the pensioners from Kosovo and Metohija), while it will reach 3.8 billion dinars or about 37% (4.1 billions including the pensioners from Kosovo and Metohija) by the end of 2002. The Government deliberately decreased the old-age pensions and disability insurance contributions in order to unburden the economy and to reduce evasion of contributions. The lack in funds will be covered from the budget until an increased level of salaries and greater efficiency in collecting contributions is achieved. The efficiency in contribution collection has been increased in the last few months, although about 3 billion dinars of the contributions for the first six months of 2001 have not been collected yet.

7.) **The mortality rate of pensioners** in Serbia shows an inclining tendency. The number of suspended pensions due to the death of recipients was up by 25% in 2000 compared to 1994.

[1] Including the spending necessary for functioning of the funds.

In Table 1 it might be observed that the effects of two amendments to the Law from 1992 and 1996 (which caused an increase in the number of pensioners) are exhausted at present, and a declining tendency in the number of suspensions due to the death of recipients in relation to the number of new pensioners should be expected, partly owing to the potential increase in living standard and extension of life expectancy.

Table 1.

Year	New (1)	Permanent suspensions (2) Due to death (3)	Others (4)	Total (5)	Number of deceased by 100 new pensioners (3/1)
1994	73,776	40,586	10,793	51,379	55
1995	88,510	39,082	8,614	47,696	44
1996	93,443	44,029	4,442	48,471	47
1997	81,936	42,027	3,308	45,335	51
1998	65,350	48,313	8,874	57,187	74
1999	71,190	49,566	8,700	58,266	70
2000	63,658	50,911	11,943	62,854	80

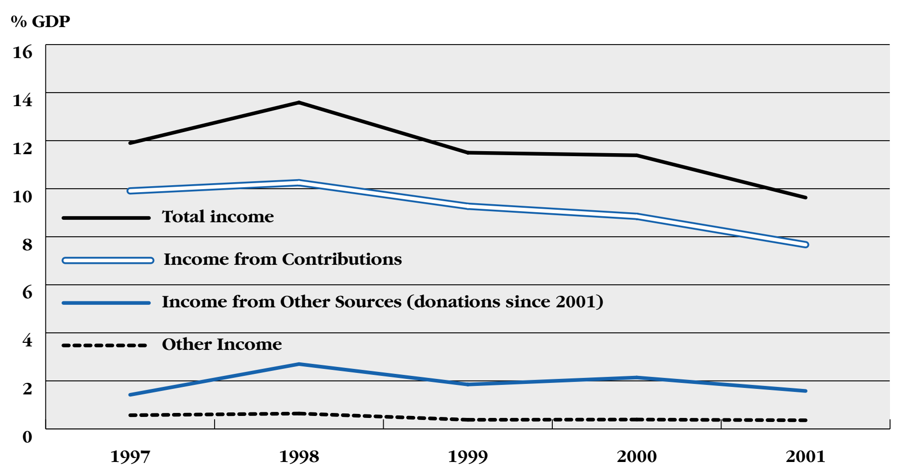
Source: Republic Old-age Pension and Disability Insurance of Employees

8.) **The old-age pension reception period** averages 14 years for men and 15 years for women. Old-age pensioners live to approximately 72.6 years (men 73 and women 71 in 2001). The pensioners in Serbia enjoy their pensions for a relatively short period compared to the other, especially developed countries.

9.) **The deficit** that all three funds for pension insurance have faced for several years is also an important issue. The relatively highest deficit exists in the Old-age Pension and Disability Insurance Fund of Farmers (the share of deficit in total fund spending was 49.4% in 1997 and 9.76% in the first semester of 2001). In the Old-age Pension and Disability Insurance Fund of Employees, the share of deficit in fund spending was 27.8% and 11.9%, while in the Old-age Pension and Disability Insurance Fund of Self-employed it was 14.1% in 1997 and 7.3% in the first semester of 2001.

Total GDP share of social insurance expenditures is down

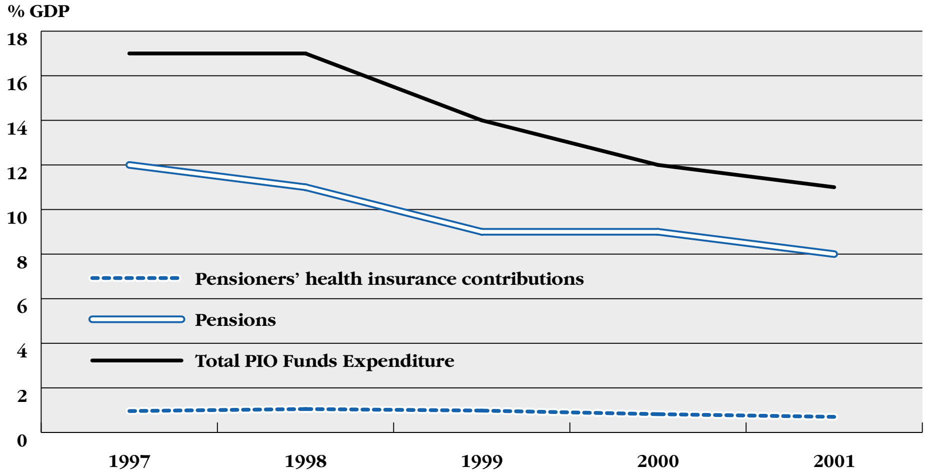
PIO Funds income, % GDP



The share of deficit was significantly reduced in all three funds by the 1998 Law on provision of sources for social programs, which provided additional sources for pension and disability insurance and other social needs. The deficit was also reduced through reduced spending due to late payments, avoidance of the adjustment and growth in the number of permanent pension suspensions. The funds collected by enforcement of the law in 2001 have been included in the budget and used for subsidizing the funds of pension and disability insurance. In the structure of income of the Fund of Employees, those funds participated with 12.1% in 1997, while today it reaches 16.24%. The share of these funds in income of the Fund of Farmers is even more significant: 20% in 1997, as compared to even 39.77% in 2001. The share of the additional funds in GDP ranged from 1.42% in 1997, and 2.7% in 1998, to about 1.6% in 2001.

On the following graphic it may be seen that net pensions stand as the biggest item in the structure of expenditures in all three funds, reaching 16.61% of GDP in 1997, and about 10.9% of GDP in 2001. The contributions for the health insurance of pensioners in all three funds make 0.96% of GDP in 1997 and 0.7% of GDP in 2001. The large gap between expenditures for pensions and total expenditures is caused by other spending necessary for the fund's functioning, dominated by the share of extraordinary and so-called "non-business" expenditures, reaching 3.8% of GDP in 1997, even 4.68% of GDP in 1998 and about 2.4% of GDP in 2001.

PIO Funds Expenditure, %GDP



The Experience of Countries in Transition

Pension system reform in transition countries is generally at a later stage of transition

In post-communist Europe, PAYG systems suffered a series of shocks in the 1990s due to the transition process to a market economy. The decrease in economic activity resulted in a decrease of contributions for old-age pension and disability insurance, while unemployment and the shadow economy were growing. Besides, pension systems in post-communist countries were often used to ease the adaptation of the labor market through early retirement of older workers. This resulted in growth of the implicit public debt (the present net value of the promised pensions that are owed to the current pensioners and workers due to their participation in the old system) for pensions that threatens to destabilize the current systems. In the post-communist countries, the elderly support ratio (the ratio of the number of pensioners to the number contribution-payers) suddenly increased in the course of transition.

The governments were trying to adapt in various ways. In some countries (i.e. Poland, Latvia, Bulgaria, Slovakia), the governments were raising the contribution rates so as to finance the growing expenditures for pensions. In others (Hungary, the Czech Republic, Croatia), the governments controlled the expenditures through systematic or ad hoc distribution of the pensions. In some countries (Kazakhstan, Romania, Russia), they maintained the same level of the pension expenditure through significantly late payments.

In the mid and late 1990s, most CEE countries undertook major pension reforms; but the pace of decision making and implementation has differed markedly from country to country. In some countries, legislation has been approved and is now being implemented (e.g. Hungary, Poland and Latvia); while in others the debate is still underway (e.g. Slovakia, Ukraine). The reforms aim not only at reducing system dependency ratios, but also at adapting some of the pre-transition design features to new economic and political conditions. In all cases, this has meant a move away from universal redistributive policies toward systems in which benefits are more individualized and earnings related. In many countries reform has also entailed a shift toward greater reliance on the private sector for pension provision. The result is a growing differentiation both within and among countries in the extent of protection provided.

The options for pension reform open to CEE countries are shaped by the characteristics of the pension systems they inherited, the impact of economic and policy changes on these systems during the early years of the transition, and the likely influence of demographic developments in coming years.

CEE countries have taken different approaches to pension restructuring and are proceeding at different paces, a situation which allows those at earlier stages to benefit from the experience of others that have moved further in implementation of reforms.

Table 2

Country	Current law	Men	Women
Albania	1995	60 with 35 years of service; partial pension with 20-35 years	55 with 35 years of service; 50 with 30 years of service and six children; partial pension with 20-35 years
Croatia	1998	Increasing to 65 with 15 years of work by 2007. Anticipatory pension increasing to age 60 with 35 years of work	Increasing to 60 with 15 years of work by 2007. Anticipatory pension increasing to age 55 with 30 years of work.
Czech Republic	1995	Increasing from 60 to 62 with 25 years of service, at a rate of 2 mos. per year between 1996-2006	53-57, depending on no. of children, increasing to 57-61 at a rate of 4 mos. per year between 1996 and 2007
Estonia	1998 (in force 2000)	62.5 increasing to 63 in2001	57.5 increasing to 63 in 2016
Hungary	1997	62	57, increasing to 62 in 2009
Latvia	2000	Increasing from 60 to 62 in increments of 6 mos. per year	Increasing from 57 to 62 in increments of six mos. per year
Lithuania	1994	61, increasing in increments of 2 mos. Per year to 62.5 in 2009	57, increasing in steps of 4 mos. per year to 60 in 2009
Macedonia	2000	Will become 64 (31/12/01) with 15 years of work. Transition period till 2005 during which workers can retire with 35 years of work (no min. age) if more beneficial	Will become 62 (31/12/07) with 15 years of work. Transition period till 2005 during which workers can retire with 30 years of work (no minimum gage) if more beneficial
Poland	1998	65 with 25 years of service. Early retirement being phased out	60 with 20 years of service. Early retirement being phased out.
Romania	2000	Increasing from 62 (with early retirement at 60) to 65 by 2013	Increasing from 57 (early retirement at 55) to 60 by 2013.
Slovak Republic	1988	Normal retiring age is60; for selected professions, 55-58 with 25 years of service	Normal retirement age is 53-56, depending on no. of children raised, with 25 years of service.
Slovenia	2000	Increasing from 61 to 63 for full retirement, with 40 years qualifying period, minimum retirement age 58	Increasing from 53-58 to 58-61 for full retirement with a 38-year qualifying period, minimum retirement age 58.

Source: Pension Reform in Central and Eastern Europe: An Update on the Restructuring of National Pension Schemes in Selected Countries, ILO-CEET, Report No. 25 (2000), p. 13

Introduction of a voluntary third pillar

From a chronological perspective, the earliest changes separated social security from the state budget and provided separate financing or accounting for the various types of benefits. All countries now have a pension budget, account, or fund which is distinct from the state budget or segregated within it. In addition, several countries, including Hungary and the Czech Republic, took early action to establish voluntary supplemental pension schemes. These were intended to encourage self-reliance in old age, as well as to provide long-term investment capital. In general, it appears that membership in these schemes have fallen short of original expectations and, in some cases, attracted only a low level of savings by members.

The remaining reform measures fall into two broad categories: adjustment in the basic parameters of existing public schemes and establishment of new private arrangements for pension provision. Virtually all countries are pursuing the first approach, public scheme restructuring. The reforms underway include increasing national retirement ages, reducing redistribution and rates of wage replacement in benefit formulas, curtailing benefits to privileged categories of workers or providing a separate sources of financing for them, and strengthening procedures for collecting contributions.

Gradual increase of the standard retirement age

One of the first measures is increasing the national retirement ages as it has been gradually enacted, ranging from 2 to 3 years for men and 3-6 years for women (Table 2). Most of these new statutes are the result of political compromise, with larger increases proposed initially and reduced through a process of negotiations with trade unions and, in some cases, employers. In several countries (e.g. Poland, Slovenia) equalization of the retirement age between men and women was initially proposed, but then rejected. In some countries, a second round of increases is under discussion (i.e. Czech Republic) or has been enacted (i.e. Latvia) as a means of addressing the expected aging of the population.

The second category of reforms, new private pension arrangements, differs from the approach to privatization taken in some Latin American countries where public schemes were fully replaced. Here the objective in most countries is to structure mixed pension systems under which future retirees will receive benefits from two sources, the public scheme and a second mandatory tier consisting of commercially-managed individual savings accounts. This arrangement eliminates the pooling of risk and redistribution of income with respect to savings invested in the second tier, providing workers with a simple return on their contributions, plus investment income reduced by the administrative costs. The employees are given the possibility to choose the company that will manage their contributions and the right for occasional transfer of funds to another company. Thus the government's role is basically changed – it is not in charge of pension provision any more, but only regulates the operations of the private pension companies that make up the second pillar. The mandatory private pillar was established in Hungary in 1998, and in Poland in 1999.

The choice of reform measures depends on local conditions

Since these reforms have been implemented recently, it is hard to make any definite conclusions, but several trends can be observed. In general, the analysis shows that:

1. The transitional costs of moving from PAYG financing to pre-funding of pensions are turning out to be higher than projected in both Hungary and Poland, due primarily to larger than expected numbers of workers opting for private pensions. In the range of 0.5-1.2 % of GDP per year, these transitional costs pose a heavy fiscal burden. Those countries face the problem of high transitional costs since they have to make reserves for the new funded pillar, while at the same time they have to fulfill the existing PAYG pension obligations. In CEE countries it is very hard to make reserves since the contribution rates are already too high relative to the other parts of the world. The countries that tend to be competitive internationally are under the pressure to reduce those rates or at least to stabilize them. Consequently, the problem of the transitional costs must be resolved in other ways.
2. The political and economic environments in which pension reform is carried out are volatile in most CEE countries, due to small and newly established markets and frequent changes in government. The former is leading private pension managers to invest high levels of worker savings in public, as opposed to private, securities, while the latter is leading to mid-course revision in reform policies. The lack of continuity is most problematic with respect to radical reforms which must be put in place over a period of years.
3. Key issues related to the structure of private benefit payments are as yet unresolved in both Hungary and Poland. The governments in both countries were more concentrated on putting the new private system on the firm footage, further postponing to resolve the pension related issues. The most significant question in Hungary is how to adjust pensions with the inflation growth. Under the law, the adjustment must be proportional to the annual changes in wages and prices. While the Government can guarantee such protection, it is not clear how the private funds arrange the indexation. These uncertainties left current workers in both countries without knowledge needed to make an informed choice of whether to join a new private supplement scheme or not
4. The variety of reform measures being pursued across the region is increasingly diverse. While several countries are planning radical reforms along similar lines with Hungary and Poland, others, i.e. the Czech Republic, Estonia and Slovenia are restructuring their public pay-as-you-go schemes without establishing a mandatory private pillar. A key consideration for those governments which have taken the latter approach is the fiscal burden of high transition costs
5. Social dialogue on pension reform is limited in most CEE countries, and tripartite consensus is not often achieved. This is due in part to the lack of tradition for such dialogue, to some governments' failure to recognize the need for it, and to limited experience on the part of workers and employers in fulfilling their roles. The degree of consensus achieved in Poland stands out in demonstrating that support by the social partners can help to provide stability for reform legislation, keeping it on track despite changes in government.

Social Dialogue – difficult but necessary

A Proposal of Reform Measures

Pension system reform in Serbia is necessary. With regard to its design, the following actions could be carried out:

1. Reduce the number of new pensioners through:

- Reducing the benefits of the early retirement for particular occupations. The benefited years of service should be kept only in cases when the employee is no longer able to do any kind of work (e.g. miners). It should not be applied when the employee is not able to do his or her initial work, but still has a certain degree of working ability (e.g. ballet dancers).
- Limiting the misuse of the disability insurance.
- Rising the standard retirement age (e.g. to raise gradually the standard retirement age in concordance with the increase in life expectancy at birth). Some actors of the social consensus might disagree with this measure. The most vulnerable group is employees who are to reach the retirement age soon, which might be an obstacle for further implementation of the reform, as it was the case with some CEE countries. Therefore, raising the standard retirement age must be carried out gradually, paying special attention to not affect the rights of employees who almost accomplished the formerly required years of service. Thus, potential tensions would be avoided and the negative impact on age-structure of the employed reduced, but at the same time it would diminish the expected positive effects.
- Enabling those who achieved the right to retire to continue working in agreement with the employer.

The new market environment will demand deeper reform over time

2. Lessen the average pension amount, directly or indirectly through:
   - Gradually equalizing the position of men and women in terms of the conditions for retirement and the value of pension.
   - Change the accounting method. Namely, calculation of the pension value should be based on the wages earned during all years of service, and not as it is now calculated on the 10 best years. Pensions should be related to the pension insurance contribution that the employee has paid during his years of service, instead of the current system where pensions are related to the wages. This new system is better in an actuary sense and increases the employees' interest in paying contributions. The employees are interested in the value of their wages during all years of service, not only in a ten-year period, thus reducing the inclination for out-of-wage payments.

3. Enable all interested persons to have voluntary pension insurance, regardless of if they are formally employed.

Most of the suggested solutions might have medium-term effects, but will not solve the essential problem. Therefore, a deeper reform of the pension system is necessary. Reform can keep the current PAYG system (with suggested changes), but with a trend toward reducing its participation in favor of pre-funding (state and private). At a lower level, the PAYG system may serve for the redistribution of income and prevention of poverty in old age, while income from pre-funding will allow individuals a chance to maintain the living standard they had before retirement. Another important purpose of pre-funding in transition countries is the establishment of an institutional framework for fast growth in savings and for strengthening financial and capital markets.

Open and participatory processes produce superior and more sustainable outcomes

In all CEE countries where the process of pension system reform is underway, even in those in the late stages of reform (Poland, Hungary), there is an evident lack of information and knowledge among the wider public. The transparency of the reforms and education of the population in Serbia is an even more significant issue for several reasons. Firstly, due to the negative experience with privatization from the beginning of the transition process, old hard currency savings and pyramid banks. Secondly, it is very hard to carry out reforms without consensus, which cannot be reached if the main actors of the consensus are not sufficiently informed and if there is space for speculation. According to the experiences of some countries (Poland, Kazakhstan, Hungary), the greater the number of actors included in first stages of decision-making and negotiating, the more optimal the agreement in implementation, as well as the greater the sustainability of reforms through the course of changes in government.

Each pension system model has particular effects on the safety of income at retirement, financial issues of the system, on the labor market and the capital market. The reform affects all categories of the population and has long-term effects. Therefore, it is a very delicate process that should be initiated as soon as possible, but only after precise estimation of the costs and benefits of different alternatives.

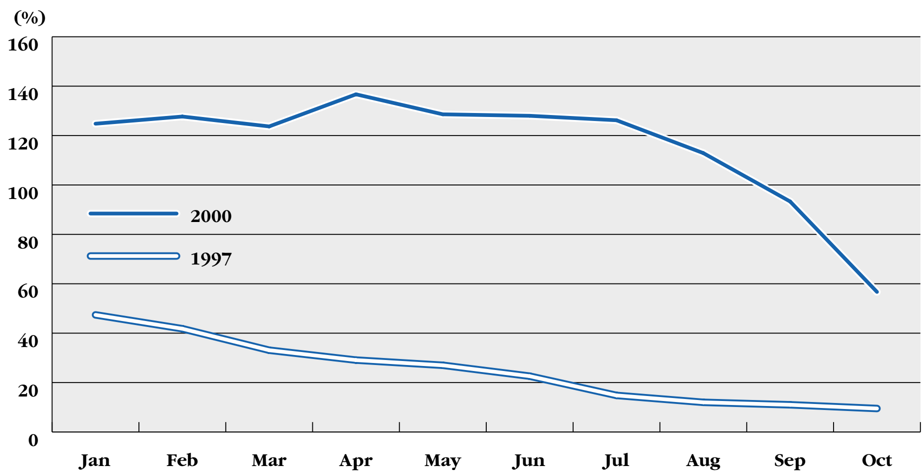
MACROECONOMIC REVIEW

Prices

Retail prices in Serbia were up 2.6% in October. With the increase in October, the total retail prices increase in 2001 reached 36.3%. Although the price of services rose at a faster rate in October, reaching 2.9% at the end of the month, total retail price growth resulted from the increase in prices of both goods and services. The highest increase in prices is registered in the price of public utilities, and was mostly influenced by the increase in the price of heating. As for industrial producer prices, the highest increase was registered in industrial non-food products, due to the increase in the price of electric power for households. The average increase in the price of electric power in October was 11.8%.

Inflation in Serbia

Monthly inflation is on a downward trend



Since July the annual inflation rate, standing as the sum of the inflation rates in 12 months, *has shown a declining tendency.* Total inflation measured by the level of prices year-on-year is 65.5%, while total inflation measured by the total retail price increase for the first ten months of this year was quite high at 108.9% relative to the same period last year. However, the gradual correction of artificial price disparity in 2001 contributed to the reduction of huge differences in annual inflationary indicators that were inherited from the former period.

Monthly Indices of Price

2001	I	II	III	IV	V	VI	VII	VIII	IX	X	I-X
CPI	**103.2**	**101.5**	**102.3**	**111.3**	**103.5**	**104.7**	**101.8**	**102.9**	**101.8**	**102.9**	**141.9**
Foodstuff	100.8	100.1	103.0	110.0	104.4	101.6	101.4	104.2	103.0	101.6	134.2
Living Nutrition	99.4	100.9	106.6	117.3	102.0	103.0	101.7	109.0	103.2	100.6	151.7
Foodstuff [B]	101.7	99.6	100.5	105.2	106.1	100.6	101.2	101.0	102.8	102.3	122.5
Housing	113.9	102.6	102.7	127.6	101.2	119.1	100.5	99.9	100.3	108.0	200.9
Electricity	100.1	100.0	100.0	159.3	100.0	139.7	100.0	100.0	100.0	111.7	248.7
Utilities	189.3	108.4	101.9	102.1	103.4	100.6	100.4	102.0	101.5	100.0	231.0
Rent [B]	111.0	104.4	106.4	94.3	102.2	97.9	101.3	99.2	100.3	105.5	132.0
Transport and Telecom	103.5	104.5	100.0	109.4	100.3	102.5	118.5	118.6	100.8	100.2	172.8
CPI [B]	**102.6**	**101.5**	**101.3**	**104.2**	**104.6**	**101.3**	**101.3**	**100.6**	**101.6**	**102.7**	**122.5**

Note: Consumer Price Index [B] (CPI [B]) represents a basic inflation indicator. It has been calculated on the basis of the CPI, from which bred, meat and milk, electric power, public utilities, transport and postal services have been deducted. In total, 33.4%

Source: Republic Bureau of Statistics

At the beginning of the last trimester, *the cost of living increased faster than retail prices.* With the monthly rate of 2.9% in October, total cost-of-living growth rate for the first ten months was 41.9%. The growth in costs of living in October was mostly influenced by an increase in the price of public utilities (due to correction in prices of fuel and street and building light), a seasonal increase in the price of footwear and clothing and an increase in the price of food products. Due to the mentioned increase in prices, the price of services that are part of the costs of living showed faster growth in October and reached the figure of 4.4%, while the price of goods in the same month were up 2.7% on average.

The dynamics of growth in industrial producer prices continued in October. Industrial producer prices were up 2.1% on average compared to the previous month. The long-term growth rate in industrial producer prices is faster than the long-term growth rate in retail prices. Such dynamics indicate that industrial production is not competitive even on the domestic market due to high costs, and even more so on the foreign market. High domestic industrial dependence on import, the experience of earlier devaluations, as well as a very low degree of producer productivity and efficiency suggest that noticeable depreciation would lead to rising inflation, but not to a significant improvement in competitiveness. Therefore, the solution for increasing exports should not be sought in depreciation of the foreign currency exchange rate, but, above all, in the improvement of performance in industrial production.

According to the price dynamics in this year, at the beginning of the last trimester we may conclude that the market itself regulates the majority of prices of goods and services. Most prices were liberalized after October 2000. The prices of public utilities and power sources are gradually being liberalized. By reaching an economic price for electric power, which is expected in April 2002, and a more realistic price for public utilities (including the price of public town and suburban transportation), only a minor share of prices will still be under control. Thus, price formation in the upcoming period will largely depend on economic factors.

Wages

The average net October wage in Serbia (without working-hours meal allowance, annual leave contribution, field and other allowances) was *6,553 dinars (215 DM) applying the accounting method effective until June 1*, or 7,408 dinars (243 DM) according to the new accounting methodology. The average gross wage in Serbia in October was 10,647 dinars or 349 DM. The average net income expressed in DM has grown by 7.4% compared to the previous month. The difference between the average net income expressed by the current and by the previous methodology, was 13% this month.

After a slowing in the average net wage growth in September (according to the previous methodology), the average income in October displayed a real increase of 2.6%. The average wage in October showed a real increase of 37.8% year-on-year, while the average wage for the first ten months of 2001 was up by 12.6% in relation to the same period last year.

Real wages average 1.3% monthly growth

Since the beginning of the year, nominal net wages in Serbia showed an average monthly growth rate of 4.9%, while the cost of living was up by 3.6% per month, an average real net wage increase of 1.3% per month.

According to data of Republic Payment and Settlement Bureau, a total of 68.2 billion dinars were paid to the population, nominal growth of 17% month-on-month. At the same time, the total sum of 36 billion dinars was collected from the population, or 50% more compared to September. The growth of income in October was significantly influenced by the sum received in terms of realized goods and services, as well as tax, duty and contributions collections.

Nominal revenues from the population significantly increased in October, thus lowering the discrepancy between the total payments made to the population and the payment collected from the population. The gap between the total income and revenues of the population, having started to increase significantly since May, partly resulted from the fact that payments and collections from the population have different sources of financing.

Industrial production

Industrial production in the FRY was up 10.4% in October month-on-month. Production rose equally in Serbia and Montenegro. Although the rise in expressed in percent terms seems satisfactory, the deseasonalized index shows a drop compared to September.

The industrial production index was up 18% year-on-year in the FRY; in Montenegro, it showed a 10.1% drop, while in Serbia it rose by 20.2%. In Central Serbia, industrial production growth was 11.5%, and in Vojvodina it was up 37.7%.

Although the production in October was higher year-on-year, total industrial production for the first ten months this year is 1.4% down compared to the same period last year. On the same basis, it dropped 1.7% in Montenegro and 1.4% in Serbia. It is remarkable, though, that, while in Central Serbia production decreased by 6.1%, in Vojvodina it increased by 9.3%. This situation characterizes not only this month, but several previous months, as well.

The most significant conclusion is that *growth measured in Serbia is mostly due to the above average growth in Vojvodina*. This growth largely owes to the sector with the highest share in FRY industry – light industry. Comparing industrial production of this and the previous year, of 23 light industry branches in Vojvodina, 15 branches display growth, while in Serbia it was present only in seven branches. According to the experiences of countries in transition, the regions that are geographically closer to the countries of Western Europe show faster development compared to other regions. It might be a hint that transitional stratification has started in our country, too. It would be advisable that the creators of the economic policy carefully watch regional dynamics in the upcoming period, providing for as equal as possible development in Serbia.

The structure of employment shows the inflexibility of the labor market. The fluctuation (direct transfer from post to post) in Serbia in 2000 and 2001 is about 30% of the newly employed on average, while the remaining 70% of newly employed are the unemployed persons who were registered at the Bureau of the Labor Market. According to the experiences of countries further ahead in the process of transition, it is expected that the fluctuation share (direct transfer form post to post) in the total number of newly employed will increase in the course of structural reforms, privatization and inflow of foreign investments. More stringent criteria in the system of pecuniary compensations are expected to decrease the registered unemployed.

Foreign exchange

According to preliminary data for the first ten months of this year, commodity exports are valued at 1.4 billion USD, which is up 6.5% compared to the same period last year. Comparing exports in October 2000 and October 2001, exports increased by more than 20%. The increase in imports, however, is still markedly higher; from the beginning of year commodity imports are valued at 3 billion USD, which is up 19% year-on-year.

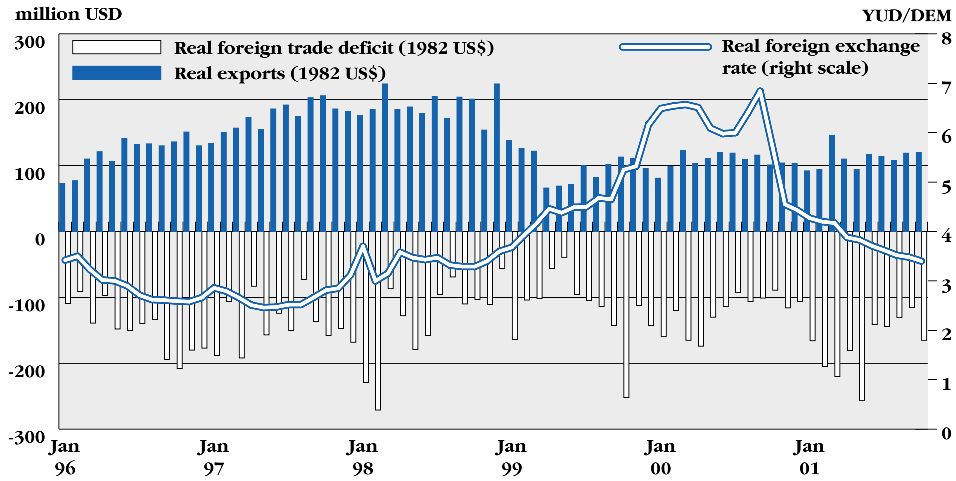
The FRY foreign trade deficit for the first ten months is 2.4 billion USD. This is in accordance with projections from the beginning of the year, which anticipated that the deficit in commodity trade would reach 2.5 billion USD by the end of year.

Export of agricultural products is slowly recovering from the effects of last year's drought. The export of grains, although down 50% from the first ten months of last year, started to increase in October relative to the previous months of this year. Since this year's crop of wheat is up by 33% and the maize crop doubled last year's yield, the balance in trade with grains should significantly improve in the course of next year, regarding the current deficit of over 15 million USD. (For example, in the same period last year, we had a surplus in trade with grain and grain products of about 45 million USD).

Agricultural export should recover in 2002

The exports of beverages and tobacco are at approximately the same level as in last year (10 million USD), while the import of these products is almost doubled (77 million USD). The increase in exports of these products resulted primarily from more a restrictive regime to control tobacco products' turnover increasing the amount of goods that are legally registered. At this point, it is interesting to mention the draft of the Law on modifications and supplements to the Customs Law and International Transactions Law. The proposed solutions, among other things, predict issuing licenses for the import of tobacco and tobacco products, as well as a strict regime for monitoring vehicles that transport these products across our country. Such solutions should contribute to the transfer of exported cigarettes turnover into legal channels, meaning a further increase in officially registered import of these products.

Exports, Foreign Trade Deficit and Real Foreign Currency Exchange Rate



The successful agreement with the Paris Club of creditors is the most important step toward regulation of the relations between Yugoslavia and international creditors, establishment of conditions for foreign investments, and long-term economic growth. As for the membership in other international organizations, an application for membership was submitted to the World Trade Organization in January 2001 and a working group on this was formed in February. The creation of a Memorandum on the foreign trade regime is in progress and should be submitted at the beginning of 2002. The procedure for joining the WTO is long and detailed, requiring harmonization of legislation and numerous bilateral and multilateral talks. The work on a new Law on foreign investments, which is to be adopted at the federal level, is in progress, as

Currency value is not the key variable in export

well as a Public Acquisition Law, which should be adopted at the Republic level. By submitting the Memorandum, we will come closer to Bosnia & Herzegovina and Macedonia. They applied for membership much earlier, but have submitted the Memoranda only this year. The other two republics of the former Yugoslavia are already WTO members, Slovenia as a founder and Croatia since November of 2000.

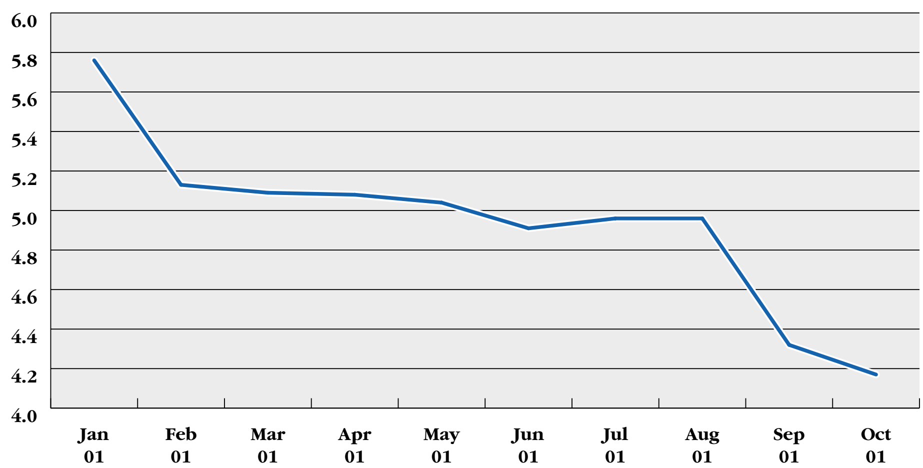
Nominal depreciation of the foreign currency exchange rate continues, but, considering the faster growth in retail prices, a real appreciation is in progress. Under normal conditions, appreciation of the real foreign currency exchange rate should result in an increase of import, decrease of export and further increase of the foreign trade deficit. Real foreign currency depreciation should have opposite effects, i.e. reduction of the commodity deficit or an increase of surplus. The table shows the course of real foreign currency exchange rate, commodity exports and foreign trade deficit (deflated by the U.S.A. producers price index in order to present comparable values). In many periods of time, the course of imports and deficit in relation to the real exchange rate does not correspond as expected. *In our country other factors have a more significant impact on the course of foreign exchange and competitiveness of domestic producers than the course of the real exchange rate.* Examination of the mutual relations of the observed values, however, requires more complex analysis.

Monetary and Fiscal Policy

The money supply increased from 52.623 billion dinars at the end of September to 56.396 billion dinars at the end of October, which represents growth of 7.17%. The primary issue was based on crediting the budget of the Republic of Serbia in the amount of 500 million dinars, foreign exchange transactions in the amount of 378 million dinars, as well as on the basis of a reduction of the bonds issued by NBY in the amount of 443 million dinars.

In October, there was a considerable increase in the gross collection of public revenues (35.501 billion dinars were collected in October, while in September it was 29.596 billion dinars). The increase in the revenues of the budget and other users is particularly significant. It increased from 18.406 to 23.155 billion dinars, growth of 25.8%. This growth is mostly due to the growth of industrial production (which results in tax basis growth), initiation of extra-profit tax collection, firmer financial discipline and reduction of the shadow economy (e.g. excise duty revenue is up from 2.75 to 3.10 billion dinars).

Average Interest Rate for Short Term Securities



The number of illiquid companies and their liabilities increased again at the end of October. After implementing the program of the regulation of internal debt at the end of September, the liabilities of illiquid entities were 35.31 billion dinars, but reached 74.73 billion dinars by the end of October, pointing to the seriousness of this problem. The main cause of chronic illiquidity lies in the unprofitable work of a large share of the economy. Without significant restructuring of these companies, the problem cannot be solved. Such high levels of illiquidity not only affect normal functioning of the economy, but also imposes pressure on interest rates, preventing their reduction.

The interest rate on short-term securities at the Belgrade exchange was down to 4.17% in October (it was 4.32% in September). This drop was influenced by a September 29 reduction in the discount rate.

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